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P 01701

PRIME MINISTER

Local Government Finance Studies:
E(LF)(85)3rd Meeting on 3 October

Item 1
Flag B — At its meeting last week, the Sub-Group made good progress in working through the proposals set out by Environment Ministers in the 'Second Specification Report' (E(LF)(85)4). Among other things, it was decided to retain a power to rate cap, and to reject the proposal to link the Government grant to a proportion of the yield of VAT. The use of capital values as a basis for property tax was also ruled out. There was, however, concern about the extent of redistribution of resources from the North to the South of England with a corresponding increase in domestic tax bills in the North, and DOE were asked to examine ways of moderating this. Other issues, such as the Education Secretary's proposal for an education grant, were not examined then.

2. The present meeting provides an opportunity to take forward discussion on three particular issues:

(i) The Education Secretary's proposal that there should be a separate education grant. DOE will need guidance on whether this is to be pursued further. The Sub-Committee may be able to reach a decision on this reasonably quickly;

(ii) DOE have done further work on the distributional effects of their package between authorities, and have identified a number of ways of modifying the more extreme effects. This item is likely to take the greatest amount of time, and indeed it may not be possible to resolve all the issues now. But DOE will require some guidance as to what options should remain in play so that they can carry out more detailed examinations of the distributional effects both between and within areas;



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(iii) There is a short paper on the timescale for the remaining stages of reform. You may wish to reserve the last 15 minutes of the meeting to consider this.

Briefs for each item are attached.

3. The question of the "community" or "local" charge is not on the agenda today. DOE have work in hand on various combinations of personal and property elements, and on the best basis for assessing the property elements, and will report back later. But they need a decision on item (ii) above today before they can work out the household effects of the package.


4. DOE have also circulated a paper about the legislative aspects of rate capping and particularly whether this should be part of the initial legislative package, or held in reserve. This is an important tactical and presentational point but need not be discussed at this meeting.

5. At the last meeting you referred to the importance of identifying the combined effects of the Social Security Review and the Local Government Finance package. Work has been commissioned from the Treasury, and the first opportunity of taking stock will be the meeting of MISC 111 on 15 October.

6. Finally, you may wish to close the meeting with a further injunction against reporting the outcome to the press. There have been further extensive leaks of the state of the discussions.

J B UNWIN

Cabinet Office
2 October 1985


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Local Government Finance and Education
(E(LF)(85)6)

BACKGROUND

Flag A
Flag B
Discussed at the last E(LF)

The Memorandum by the Secretary of State for Education and Science (E(LF)(85)6) welcomes many of the proposals set out in the Environment Secretary's second specification report (E(LF)(85)4). But he proposes a fundamentally different way of dealing with the Exchequer Grant to local authorities, designed to increase central Government's influence over the priorities and policies of local authorities. His proposal is opposed by Environment Ministers.

MAIN ISSUE

2. The main issue is whether the Exchequer Grant to local authorities should be in the form of a lump sum for all services, leaving local authorities to determine local priorities, or whether there should be separate grants for each service, thus giving Whitehall much greater influence.

The DOE Proposal

3. DOE Ministers have proposed that there should be a single fixed lump sum grant to local authorities, comprising a 'needs' element designed to compensate for different levels of needs, and a standard element, paid at a fixed sum per head across the country. The needs element would be calculated by reference to indicators for particular services - eg the number of children requiring education - but local authorities would determine how to allocate their resources between services.

The Education Secretary's Alternative

4. Sir Keith Joseph contends that such an arrangement would not give him sufficient influence over the education service. He argues that



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since education has a national as well as a local dimension, and the Government is held accountable for performance, he should be responsible for educational support to local authorities in the form of an education grant, and that the needs assessment should be more influential in determining appropriate levels of spending on education. Local authorities would have no power to switch resources between education and other services.

5. Sir Keith also argues for greater use of specific grants, which could be allocated at his discretion and would give him greater influence in securing national policy objectives.

Argument

6. Sir Keith's alternative for the Exchequer Grant is compatible with the other elements of the DOE Local Government Finance package. It is therefore a straight choice between the approach suggested by Sir Keith and by DOE Ministers.

7. The key issue is the degree to which local authorities should be free to determine their own priorities and policies. Sir Keith's proposal would represent a considerable centralisation of power on top of the proposed nationalisation of non-domestic rates, giving him, and presumably other Service Ministers, much greater influence than they have had so far. While there are obvious attractions in this to Service Ministers, it would be a fundamental constitutional change, running contrary to the main emphasis of increased local accountability.

8. An alternative would be to fund a greater proportion of education through specific grants. It has already been proposed that there should be a study of specific grants under Treasury chairmanship, and you may think that this would be a more sensible option to explore.

9. You will wish to invite the Education Secretary to introduce his proposal. The Environment Secretary will wish to reply. Other Ministers responsible for local Government services will have views.



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CONCLUSION

10. You will wish to reach decisions on:

(i) whether there should be a single lump sum grant paid to local authorities, or alternatively as the Education Secretary proposes a separate education grant;

(ii) whether consideration should be given to putting greater emphasis on specific grants which would enable Service Ministers to have a more direct influence on the achievement of national policies.

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Timetable
(E(LF)(85)7)

BACKGROUND

Flag A
The last meeting of the Sub-Committee agreed that the aim should be to produce a consultative Green Paper on the Local Government Finance Studies before the second reading of the Social Security Bill, so that the House can be aware of the potential impact on household incomes of the rates reform before they debate the social security and housing benefit proposals. The Environment Secretary's memorandum considers what would be required in order to achieve that timetable. He also reviews the various options for implementing the proposals in the longer term.

MAIN ISSUES

2. The main issue requiring a decision is whether it is realistic to aim for a Green Paper before the second reading of the Social Security Bill. At this stage the options beyond that need only be noted.

The Immediate Timetable

3. Our best advice remains that, if Mr Fowler's package is to be implemented in April 1987, second reading of the Social Security Bill must be held before Christmas. This is to ensure that Royal Assent will be obtained before the summer recess, which DHSS assure us is a necessary condition of making the arrangements for implementation in April 1987.

4. If, therefore, the local Government Green Paper is to be published by around mid-December, it will be necessary to complete the work, make all remaining decisions, and draft the Green Paper within 9 weeks. The Environment Secretary's paper rehearses the questions that need to be settled and suggests that such a timetable may be unrealistic. He

proposes instead that there should be an announcement of the broad approach of the package before the second reading of the Social Security Bill, with the Green Paper itself being published 'at the turn of the year'. This would be during the Committee stage of the Social Security Bill.

5. It will clearly be difficult for the Government to explain its social security policies (especially on housing benefit, with the proposal that recipients should pay a minimum of 20 per cent of their rates bill) in the absence of a clear indication of the likely effects of the Local Government Finance package. Local authorities, who will have to change the administrative procedures to implement the housing benefit reforms, will also face further upheaval under the rates reform. It should be noted, however, that not all the outstanding issues that a Green Paper would have to expose are directly relevant to the question of interaction with the social security initiative. Furthermore, the Environment Secretary's safety net proposal would make presentation easier, since it would be possible to say that the Government did not intend the local Government reform to result in major changes between areas.

6. The Sub-Committee will need to balance the risks of encountering difficulty in the second reading of the Social Security Bill against that of pressing ahead with the local government finance proposals more quickly than is prudent. The potential for banana skins on such a complex issue is clearly considerable. My own view is that it would be wise to explore Mr Baker's alternative that a statement (rather than the full Green Paper) should be published in December, setting out the general principles of the proposed changes and giving as much assurance as possible about the effects on household incomes. You may wish, however, to ask him how explicit such a statement could be and what it could cover, and to obtain his assurance that if the Green Paper were postponed from December to the turn of the year DOE would nevertheless continue to work on the Green Paper at full steam ahead.

The Longer Term

7. The Environment Secretary's paper sets out three possibilities for



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the introduction of the new regime. You will not wish to reach final decisions at this stage, since the timing of the election is clearly a crucial factor. It may only be possible to make decisions as events unfold. But the key consideration is should a Bill be introduced before the next election. There will be political advantages and disadvantages in doing so. But if it were decided to hold up the Bill until after the election, and if the election did not take place until towards the end of the lifetime of the present Parliament, there could be a two-year gap between the publication of the White Paper and the introduction of the Bill itself.

HANDLING

8. You will wish to invite the Environment Secretary to introduce his paper. The Lord President and the Chancellor of the Duchy of Lancaster will no doubt have views about the Parliamentary handling and the general problems of timing and presentation.

CONCLUSION

9. You will wish to reach decisions:

(i) on whether it is realistic to attempt to produce a Green Paper before the second reading of the Social Security Bill, and if not whether to agree to Mr Baker's proposal of a more limited statement at that time;

(ii) to note the various options for progress thereafter.



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Distributional Effects

(E(LF)(85)8)

BACKGROUND

At their last meeting the Sub-Committee were concerned at the extent of the re-distribution from the North to the South of England resulting from the DOE proposals, and DEO were asked to examine ways of moderating these effects, including the possibility (which you floated) of capping non-domestic rates rather than centralising them.

Flay A - 2. The paper by the Environment Secretary (E(LF)(85)8) suggests four possible modifications to the basic proposal which would limit the extent of losses to local authorities in the North and in London. These can be summarised as:


- (i) capping the non-domestic rate at current levels, with an equalisation grant and a device to prevent London gaining unduly;
- (ii) retaining domestic resource equalisation;
- (iii) a compensation system based on average regional incomes;
- (iv) a safety net grant to cushion losing authorities against the effects of the package.

MAIN ISSUE

3. The main issue is which, if any, of the proposed modifications should be adopted.

The Re-Distribution Effects

4. The shifts in the average local tax bill between authorities are



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caused by the proposals to 'nationalise' the non-domestic rate and to remove resource equalisation in the grant distribution mechanism. (The switch from domestic rates to a "community" or "local" charge affects only the distribution of tax bills within an area, not between areas). Under the basic DOE package, average domestic bills would rise in 111 areas (30 per cent) and fall in 255 areas (70 per cent). But average bills in the northern region and Yorkshire and Humberside would rise by between one-quarter and one-third, and in London by 13 per cent on average. In the South-East and West Midlands average tax bills would fall by up to a third. (The effect on households would depend on their composition and the actual form of the proposed local charge.) This pattern of gains and losses is inherent in the DOE proposals, and represents the removal of the substantial (though largely concealed) inequities and cross subsidy in the present grant arrangements. Nevertheless, as the Committee has identified, considerable public opposition can be expected from the areas which would lose under a fairer system.

5. DOE have identified four possible modifications. These would either covertly or explicitly redistribute resources away from the gainers to the losing authorities, and so would necessarily complicate the proposed arrangements and run counter to the fundamental logic of the system.

6. The first three proposals require a modification of the grant mechanism to include an element of resource equalisation. Each can only be targetted very broadly (towards type of authority or region as opposed to individual authorities) and specific arrangements would be needed for London. Each can also be criticised as running against the fundamental principles underlying the DOE basic package, as indeed they must if they are to cancel out many of the distributional changes it introduces.

7. Option (iv), the introduction of a specific 'safety net' grant, in the most explicit device, and the least in conflict with the main DOE package. If the grant were fixed in cash terms, it would wither away in real terms over time, and the marginal pressure of the new



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proposals and the spending/taxation link would remain intact. If the principle of such a grant were accepted, it could be found from within the existing exchequer grant. In this case, while the grant would still ensure that Northern and London authorities do not lose, this would be at the cost of authorities in the South East who would otherwise have gained. But you may feel that this is acceptable, since criticism of the Government by the losers of any reform generally far outweighs the thanks of gainers. The alternative is to use new exchequer money, estimated at about £600 million. But such a high PSBR cost - effectively transferring a greater share of the burden of local authority spending from the rate payer to the tax payer - hardly seems justified.

8. A further point is whether such a grant should be transitional or permanent. Mr Baker suggests a fixed cash sum for three years, with a review at the end of that period. Such reviews can only too easily arouse expectations and build up commitments; but it does not seem necessary to take a final decision^{on} this tomorrow and you may feel that this compromise could be accepted provisionally as a basis for further work.

HANDLING

9. You will wish to invite the Environment Secretary to introduce his paper. All Ministers will have views as to whether the proposal goes far enough in ameliorating the distribution effects of the DOE package, and on which of the proposed mechanisms is the most promising for dealing with the problem.

CONCLUSIONS

10. You will wish to reach a decision on which, if any, of the proposed mechanisms should be incorporated into the package. In the event of option (iv) being adopted, you will wish to decide whether this should be financed within existing resources or by new money; and (provisionally) on whether it should be permanent, transitional, or fixed in cash terms subject to a review.